

**SOAH DOCKET NO. 582-08-2863
TCEQ DOCKET NO. 2008-0093-UCR**

APPEAL OF THE RETAIL WATER	§	BEFORE THE STATE OFFICE
AND WASTEWATER RATES OF	§	
THE LOWER COLORADO RIVER	§	OF
AUTHORITY	§	
	§	ADMINISTRATIVE HEARINGS

**WEST TRAVIS COUNTY MUD NOS. 3 AND 5's
REPLY TO THE EXCEPTIONS TO THE PROPOSAL FOR DECISION**

TO THE HONORABLE COMMISSION:

COME NOW Appellants West Travis County Municipal Utility District Nos. 3 and 5 (the "Districts") and file this, their Reply to the Exceptions to the Proposal for Decision ("PFD") filed by the Executive Director ("E.D.") of the Texas Commission on Environmental Quality ("Commission") and the Lower Colorado River Authority ("LCRA") in the above-captioned matter.

The E.D.,¹ the City of Bee Cave ("Bee Cave"),² and the Districts all agree that insufficient information exists in the administrative record to calculate the actual revenue requirement or the corresponding rates based upon the actual revenue requirement. As a consequence, the instructions from the Administrative Law Judge ("ALJ") to calculate new rates on partial data and assumptions³ resulted in four (4) parties developing four (4) different results,⁴ and LCRA is no closer than it was at the beginning of the hearing process to proving its burden and validating its August 22, 2007 rate increase.

¹ E.D. Exceptions to the PFD at 1, 4-7.

² Bee Cave Exceptions at 6-9, 11-13.

³ PFD at 67.

⁴ The Districts concur with Bee Cave, but point out that the difference in the new revenue requirement and rate analysis is attributable only to the Districts' debt service coverage calculation.

In accordance with the ALJ's instructions, the Districts made a good faith effort to calculate a revenue requirement and rates⁵ despite the absence of vital information in the administrative record. Presumably, the other parties did likewise, again with varying results. As set forth more fully below, the E.D. and LCRA made numerous *new* flaws in this post-hearing calculation process, which errors only serve to highlight the inherent problem created by the ALJ's directions – it is impossible to calculate new rates on the basis of deficient information that LCRA failed to introduce into the administrative record. Literally, the “devil is in the details,” and the administrative record is deficient in the details necessary to calculate new water and wastewater rates for the West Travis County Regional Water and Wastewater Systems (“WTC Water” and “WTC Wastewater”). Therefore, without sufficient evidence in the administrative record and with the LCRA failure to meet its burden of proof that the rates LCRA adopted in August 22, 2007 were just and reasonable, the Commission is bound to reinstate those water and wastewater rates in effect prior to the August 22, 2007 LCRA rate increase consistent with its prior decisions in the *Double Diamond Utilities* and *North San Saba* cases.⁶

Almost four (4) years down the road, allowing LCRA to reopen, relitigate, and repair a flawed ratemaking process would be patently unfair to the Districts' approximately 3,500 residents as well as to the approximately 25,000 other customers of these systems.⁷ As the ALJ already correctly determined, the evidence in the record shows that LCRA used unjust and unreasonable

⁵ Districts Exceptions to the PFD, Attachment A, Tables 1-4.

⁶ *Id.* at 4-9; *Application of Double Diamond Utilities, Inc. to Change its Water Rates and Tariff*; SOAH Docket No. 582-08-0698; TCEQ Docket No. 2007-1708-UCR (November 12, 2009) (“DOUBLE DIAMOND UTILITIES” CASE); *Application of North San Saba Water Supply Corporation to Change its Water Rates*; SOAH Docket No. 582-09-0660; TCEQ Docket No. 2008-1481-UCR (June 7, 2010) (“NORTH SAN SABA” CASE).

⁷ There is nothing to prevent LCRA from adopting new rates as soon as this case is concluded.

forecasting and allocation methodologies, and the Districts submit that the current evidence in the record shows that the implementation of those methodologies also resulted in unreasonable and unjust rates for the WTC Water and Wastewater systems. Accordingly, the Districts ask that the Commission follow precedent by reinstating the rates as they existed prior to August 22, 2007 and order LCRA to refund to ratepayers the total amount improperly collected in excess of the prior rates over a period of time not to exceed two years.

I.
REPLY TO THE EXCEPTIONS OF THE E.D.

The E.D. stated repeatedly in his Exceptions that he **“could not locate actual numbers within the record,”**⁸ **“the record was not fully developed,”**⁹ **“the ED had to make assumptions,”**¹⁰ and **“the ratesetting methodology of LCRA was not perfect.”**¹¹ Then, despite E.D. witnesses admitting that they performed no independent analysis of the LCRA rates or the underlying data,¹² the E.D. concluded, without analysis (and, in contravention of the PFD), that “using actual numbers would produce no material effect on the rates.”¹³ More troubling, the E.D. concluded that “LCRA is not required by the Texas Water Code to use any given [ratesetting] methodology”;¹⁴ therefore, any revenue requirement proposed by LCRA must be just and reasonable. He further presumed that because LCRA was “under-recovering its revenue

⁸ E.D. Exceptions at 5-7.

⁹ *Id.* at 1.

¹⁰ *Id.*

¹¹ *Id.* at 8.

¹² Tr. at 2255: 8-2256:8; 2268:5-9.

¹³ E.D. Exceptions at 5-7.

¹⁴ In his Exceptions, the E.D. asserted that no legal standard even applies to LCRA. Under the E.D.’s theory, every rate increase by a retail public utility is justified, which would eviscerate the Commission’s duty under Section 13.043 (e) of the Texas Water Code. *Id.* at 8.

requirement,” then the LCRA rates must not be unreasonable.¹⁵ The E.D.’s double-negative presumption fails to satisfy the Commission’s duty that it **find every rate just and reasonable**.¹⁶ The E.D. presumed that *any* rate-setting method used by LCRA would produce just, reasonable, and non-discriminatory rates, regardless of the actual costs.¹⁷ These conclusory statements, without any supporting evidence, are a giant leap from the law and the facts in the record.

The E.D. also made a number of statements that are specifically contradicted by the record, signal a departure from his previous position, or are just plain confusing. For example, the E.D. stated that he has used FY 2007 actual data in accordance with the ALJ’s instructions,¹⁸ but that statement is only partially true, because he simultaneously stated that he could not find actual data in the record and he made numerous assumptions.¹⁹ Then, where the E.D. stated he used actual data,²⁰ upon closer inspection, the E.D. actually uses a calculated number focused solely on residential revenues – not the actual revenue collected for FY 2007, as shown in LCRA Exhibit SK-4. As set forth more fully below, the E.D.’s use and misuse of numbers, classes of customers, number of connections, etc. create fundamental errors in his analysis.

Contrary to his prior arguments in this case, the E.D. now espouses the importance of making adjustments for known and measurable changes - at least insofar as known and measurable changes were to be considered in adjusting actual FY 2007 data in determining the

¹⁵ *Id.* at 3.

¹⁶ TEX. WATER CODE ANN. §13.043(j).

¹⁷ *Id.* at 8.

¹⁸ E.D. Exceptions at 1-2, 4.

¹⁹ *Id.* at 1, 5-7.

²⁰ *Id.* at 4.

revenue requirement for the WTC Water and Wastewater systems.²¹ Of course, adjusting for known and measurable changes is the method urged by the Appellants that the E.D. previously adopted in the *Chisholm Trail* case²² but subsequently rejected during the hearing in this case, in his Closing Argument, and Reply to Closing Arguments.²³ The E.D. also attempted to justify the LCRA method of allocating overhead costs on the basis of volume by opining that, “accounting is an integral part of managing a retail public utility and setting rates . . . [a] retail public utility must consider financial implications in its decisions, not solely technical or managerial issues.”²⁴ The E.D.’s statement is simply another declaration without any basis in fact, the law, Commission precedent, or citation to the administrative record.

II.

ERRORS IN E.D. CALCULATIONS AND ATTACHMENTS

In setting out the dollar relationship between [the ALJ’s] recommendations, the rates before August 22, 2007, and the interim rates currently in effect,²⁵ as the ALJ requested, the E.D. made numerous errors in his calculations and attachments to his Exceptions. These errors, discussed below in detail, show that the E.D.’s recommendation that the Commission adopt all three (3) phases of LCRA rate increase is misplaced.

²¹ *Id.* at 1, 8.

²² *Petition Requesting Review of Chisholm Trail Special Utility District’s Rate Increase* SOAH Docket No. 582-05-0003; TCEQ Docket No. 2004-0979-UCR (May 3, 2006) (“CHISHOLM TRAIL” case).

²³ E.D. Closing Argument at 10; E.D. Reply to Closing Arguments at 2.

²⁴ E.D. Exceptions at 4.

²⁵ PFD at 67.

A. Errors in E.D.'s Revenue Requirements and Adjustments: Tables 1 and 2

The E.D. states that he took the actual FY 2007 data as a starting point. However, the numbers for allocated expenses shown in Table 1, Column C, of the E.D.'s Exceptions are **not** the actual amounts for the various costs pools that LCRA allocated to the WTC water system in FY 2007. The table below compares the allocated costs listed by the ED to those listed on LCRA Exhibit SK-4:

Allocated Cost Pools in FY 2007	E.D.'s Table 1, Column C Dollar Amounts	Actual LCRA Dollar Amounts²⁶
Operational Center	\$ 92,939	\$ 162,123
Regional	\$ 546,348	\$ 146,148
Customer Service	\$ 386,077	\$ 362,951
Water & Wastewater Common	\$ 2,110,635	\$ 1,460,736
Waster Services Overhead	\$ 770,560	\$ 1,122,659
Water Services New Business	\$ 168,492	\$ 184,206
Net Corporate Residual	<u>\$ 416,309</u>	<u>\$508,065</u>
TOTAL ALLOCATION	\$ 4,491,360	\$ 3,946,888

As can be seen by this table, every dollar amount that the E.D. included for LCRA allocated overhead costs, as shown in the E.D.'s Table 1, Column C, is incorrect. These errors impact literally every calculation and every dollar amount shown in the E.D.'s subsequent tables and calculations, including total revenue requirement and rate design. All remaining calculations are skewed because each is based on the erroneous numbers shown above. For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

²⁶ LCRA Exhibit SK-4.

1. Errors in Calculating Allocated Expenses

As shown above, the E.D.'s starting point for total amount of allocated expenses to the WTC water system was off by more than \$500,000. Then, apparently based on the FY 2007 LCRA Business Plan²⁷ and his inability to "locate the actual numbers within the record,"²⁸ the E.D. then "grossed up"²⁹ the flawed numbers from Table 1, Column C in an effort to determine the total LCRA allocations to each cost pool for allocation to both the WTC Water and Wastewater systems. The E.D. could have used the actual cost pool totals for FY 2007, as shown in the calculations included in the Districts' Exceptions, which would have allowed the E.D. to allocate the actual FY 2007 cost pools to the WTC Water and Wastewater systems based on the ALJ's directive to use direct labor instead of volume as the allocator.

The cost pool totals are discussed in the testimony and shown in the exhibits of both Mr. Raushcuber and Ms. Heddin. The actual amount LCRA allocated from the various cost pools is shown below:

LCRA Allocated Cost Pools in FY 2007	Source Document	LCRA Actual Cost Pool Totals
Operational Center	General Ledger; Exhibit BC-55; Districts' Exceptions, Table Two, Cell 1-E	\$ 242,588
Regional	General Ledger; Exhibit BC-54; Districts' Exceptions, Table Two, Cell 1-F	\$ 171,910
Customer Service	General Ledger; Exhibit BC-56; Districts' Exceptions, Table Two, Cell 1-G	\$873,537
Water & Wastewater Common	General Ledger; Exhibit BC-57; Districts' Exceptions, Table Two, Cell 1-H	\$3,468,143

²⁷ *Id.*

²⁸ E.D. Exceptions at 5.

²⁹ "Gross Up" is a term used to describe a method to back calculate a total cost by dividing the cost allocated to the individual unit by the allocation factor. For example, if the cost to WTC Water was \$1,000 and the allocation factor was 50% allocated to WTC Water, then the Total Cost Pool would be \$2,000 (*i.e.*, \$1,000/0.50).

Waster Services Overhead	General Ledger; Exhibit BC-59; Districts' Exceptions, Table Two, Cell 1-J	\$5,408,124
Water Services New Business	General Ledger; Exhibit BC-58; Districts' Exceptions, Table Two, Cell 1-I	\$390,363

Not only did the E.D. use the incorrect WTC Water allocated values and the incorrect total values for each LCRA cost pool, the E.D. also used incorrect factors to allocate costs up to the cost pools and down to both the WTC Water and Wastewater systems. Instead of using the actual allocation factors used by LCRA to “gross up” to the total cost pools, the E.D. used an over-simplified calculation of the percentage of overhead costs (excluding the overhead for New Business Development) for the WTC Water system to the total overhead costs (excluding for New Business Development) for the LCRA Water/Wastewater Utility Systems (“WWUS”).³⁰ The E.D. calculation ignored the evidence in the record regarding the actual FY 2007 allocation factors that LCRA used to allocate costs to the WTC Water and Wastewater systems.

Even if one was to use the E.D.’s incorrect methodology, the E.D. still used the wrong gross up numbers. In his Exceptions, the E.D. stated that he calculated a gross up factor for the WTC Water system of 63.9%,³¹ and he used the same gross up factor for the WTC Wastewater system.³² He simply divided \$2,650,154 by \$4,145,958, which the E.D. took from Exhibit BC-77. However, the WTC Water system projected overhead costs, less New Business Development, was only \$2,345,199, and the projected overhead costs for the WTC Wastewater system was only \$175,262. Then, instead of calculating overhead percentages for the WTC Water system or the WTC Wastewater system, the E.D. included costs for systems that are not

³⁰ *Id.*

³¹ *Id.*

³² *Id.*, Attachment B, Table 2.

part of this rate case, including costs incurred for the City of Westlake Hills wastewater System, the Lakeway raw water system, and the Glenlake Subdivision, the City of Rollingwood, and Westlake High Operation water systems. Ignoring the fact that the E.D. excluded the additional overhead cost of New Business Development, the E.D. should have used a gross up factor of 56.6%, instead of 63.9%, for the WTC Water system and 4.2%, instead of 63.9%, for the WTC Wastewater system. Again, these errors create a rippling effect of more errors throughout the E.D.'s analysis, tainting his overall conclusion.

As stated in his PFD, the ALJ found that the allocations based upon volume should have been based upon direct labor costs.³³ However, in calculating the LCRA overhead to be allocated to the WTC Water and Wastewater systems, the E.D. did not use the correct allocation factors. The correct allocation factor for Operation Center and Regional costs, based on Regional Labor, is 66% for WTC Water³⁴ and 19.9% for WTC Wastewater,³⁵ but the E.D. allocated 100% of the costs.³⁶ The correct allocation factor for Customer Service, based on retail customer count, is 39%³⁷ for WTC Water and 13.47%³⁸ for WTC Wastewater, but the E.D. again allocated 100% of the costs.³⁹ Allocating 100% of the costs is improper, because it would allocate costs totally unrelated to the WTC Water system – again costs LCRA allocated to the

³³ PFD at 31. The ALJ found the LCRA allocations reasonable based upon other factors.

³⁴ BC Exhibit No. 8, Labor-2 Column, and BC Exhibit No. 60 ($\$487,721/\$736,004 = 66\%$).

³⁵ BC Exhibit No. 8 (Labor-2 Column)($\$146,605/\$736,004=19.9\%$).

³⁶ E.D. Exceptions, Attachments A & B.

³⁷ BC Exhibit No. 8, Customer Column, and BC Exhibit No. 60 ($4,176 \text{ WTC Water customers}/10,636 \text{ WWUS customers} = 39\%$).

³⁸ BC Exhibit No. 8 Customer Column ($1,433 \text{ WTC Wastewater customers}/10,636 \text{ WWUS customers} = 13.47\%$).

³⁹ E.D. Exceptions, Attachments A & B.

City of Westlake Hills wastewater System, the Lakeway raw water system, and the Glenlake Subdivision, the City of Rollingwood, and Westlake High Operation water systems.⁴⁰

The E.D.'s assumptions regarding the total LCRA allocations to each cost pools discussed above are unnecessary, given that the actual FY 2007 amounts that LCRA allocated are already in the administrative record. Thus, the total for the each cost pool that the E.D. allocated to both the water and wastewater systems was incorrect. The allocation factors used by the E.D. to allocate costs down to the WTC Water and Wastewater systems were also incorrect. Finally, the E.D.'s allocated costs for WTC Water, as shown on Table 1, and the allocated costs for WTC Wastewater, as shown on Table 2, were again incorrect.

The E.D. also failed to make any adjustments to the allocation of Net Corporate Residual Costs, as described in the allocation of Corporate Services Business Unit Residual. The net amount of Corporate Services Business Unit residual is made up of two components: the Corporate Residual amount charged to the WTC Water and Wastewater systems and the amount credited back to the WTC Water and Wastewater systems. LCRA allocated Corporate Residual costs allocated to WSBU and subsequently to WWUS as provided in the Cost Allocation Manual ("CAM"), which the ALJ did not recommend revising. However, LCRA allocated Corporate Residual costs from WWUS to WTC Water and to WTC Wastewater on the basis of relative volumes⁴¹ instead of direct labor; therefore, to incorporate the ALJ's adjustments, the Corporate Residual costs for WTC Water and WTC Wastewater must be recalculated using direct labor, as the Districts did in Table Two of their Exceptions. The Capital Credit, on the other hand, is not

⁴⁰ BC Exhibit No. 8.

⁴¹ LCRA Exhibit 3 at 12:25-30 (James Travis testified on direct examination that the allocation from WWUS to WTC Water and WTC Wastewater was based on the allocation methodology just as the other charges from WWUS to WTC Water and WTC Wastewater were – **by volume**).

allocated on volume, so no adjustment is necessary.⁴² As the charge and the credit are calculated differently, the E.D., as well as the other parties, cannot simply make adjustments to the Allocated Net Corporate Residual as shown on LCRA Exhibit SK-4. Instead, the E.D. should have addressed the charge and the credit separately in terms of allocation. The problem with his approach is that every E.D. calculation from this point onward, including total revenue requirement and rate design, was incorrect. For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

2. Errors in E.D.'s Application of ALJ's Adjustments

The ALJ directed the removal of specific cost categories before calculating the WTC FY 2007 water and wastewater cost of services, in his Finding of Fact Nos. 91, 93, and 95. As noted in the Districts' Exceptions, the ALJ presumes that the costs included in the FY 2007 General Ledger from the various cost pools were just and reasonable, despite the fact that LCRA failed to introduce any evidence that the costs included in the FY 2007 General Ledger were just and reasonable for the provision of water and wastewater utility service to the WTC ratepayers.⁴³

The E.D. detailed his proposed adjustments in his Table 3. In each column of this table, the E.D. indicated the cost pool from which the E.D. believed individual charges should be deleted.⁴⁴ The E.D. then applied his allocation factors for each cost pool to allocate cost reductions to WTC Water,⁴⁵ but the E.D. failed to make any of the ALJ's adjustments to the

⁴² LCRA Exhibit SK-19 (The capital credit is calculated as 3% of capital projects. Because this is not allocated on a volume basis, there is no change to the corporate credit allocation in the analysis).

⁴³ The Districts continue to maintain that the ALJ erred in this approach and could have deducted significantly more costs, but followed his directive and made the re-calculations based on the ALJ's adjustments accordingly.

⁴⁴ E.D. Exceptions, Attachment C, Table 3.

⁴⁵ *Id.*

WTC Wastewater cost pools.⁴⁶ The E.D. also included many adjustments in the incorrect cost pools, as detailed on the table below. As LCRA allocated each cost pool to WTC Water and WTC Wastewater using a different allocation factor, the E.D.'s assignment of adjustments to the wrong cost pool severely impacts the E.D.'s subsequent calculations of revenue requirements for the WTC Water and Wastewater systems. The table below shows the cost pool adjustments that the ALJ proposed, the amount of the cost pool, the E.D.'s assigned cost pool, and the correct cost pool for the adjustment.

Source Document	Amount	E.D.'s Assigned Cost Pool	Correct Cost Pool
BC-24	\$ 19,726	Operational Center	WTC Direct Cost
BC-24	\$ 920,021	Water & WW Common	Water Services Overhead
BC-25	\$ 18,535	Operational Center	WTC Direct Cost
BC-32	\$ 2,400	Operational Center	WTC Direct Cost
BC-35a	\$ 16,460	Operational Center	WTC Direct Cost
BC-51	\$ 373,194	Water & WW Common	Water Services Overhead
BC-1 at 71:9-14	\$ 10,069	Operational Center	WTC Direct Costs

As stated above, the E.D. failed to include any adjustments for the WTC Wastewater system, even though LCRA allocated costs to the WTC Wastewater systems from the very same pools that the ALJ recommended reducing in Finding of Fact No. 91. Furthermore, the E.D. failed to include the other adjustments that the ALJ requested, including the exclusion for Rimrock Consulting charges (Finding of Fact No. 93) and the exclusion for the raw water use and reservation fees found in the WTC Wastewater revenue requirement (Finding of Fact No. 95).

Every E.D. calculation from this point onward, including total revenue requirement and rate design, was incorrect. For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

⁴⁶ E.D. Exceptions at 5, Footnote 7.

3. Errors in Calculating Debt Service

For debt service, the E.D. simply included the total amount requested by LCRA without any of his own analysis or apparent understanding of what charges LCRA included in debt service. LCRA allocated its debt service costs for the WTC water system based on a percentage of relative plant investment,⁴⁷ but then based the calculation on the incorrect percentage of wholesale and retail investment to the total amount invested in the WTC water system.⁴⁸ By doing so, the amount of debt service for the water system allocated to retail customers was inflated in FY 2007. For the WTC wastewater system, the record reflects that much of the debt service allocated to the WTC ratepayers was unrelated to the provision of wastewater service to the ratepayers.⁴⁹ For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

4. Errors in Calculating Operations Reserve

In Finding of Fact Nos. 107 and 109, the ALJ found that LCRA debt-funds its operating reserves and that \$0 was necessary for any additional amount for operation reserves. Despite that fact, the E.D. stated that he “could not find an actual FY 2007 operations reserve number to use”⁵⁰ and incorrectly included \$179,997 for WTC Water and \$47,340 for WTC Wastewater. The E.D.'s revenue requirement is incorrect and should be reduced by these same amounts, back to the ALJ's finding of \$0. For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

⁴⁷ Tr. at 1232:15-16.

⁴⁸ Tr. at 1409:2-5.

⁴⁹ Districts Exhibit 1 at 91:9-13; Districts Exhibit DGR-25.

⁵⁰ E.D. Exceptions at 6.

5. Errors in Calculating Debt Service Coverage

The E.D. included the incorrect amount for debt service coverage in his Tables 1 and 2. Again, debt service coverage is not an actual expense incurred by a retail public utility.⁵¹ Instead, debt service coverage is merely a calculation to determine whether a retail public utility has sufficient revenue to cover its operating expenses, its debt service expense, and a reserve amount in case of revenue shortfalls.⁵² According to LCRA Policy 301 and to its bond covenants, the revenue used to calculate the debt service coverage amount is the **total amount of revenue** available, not just rate revenue.⁵³ Thus, the amount of excess revenue, or debt service coverage, necessary to meet the LCRA bond covenants cannot simply be 25 percent of the debt service for the WTC systems, as calculated by the E.D.⁵⁴

When determining if existing revenue is sufficient to meet the 1.25 ratio for debt service coverage, the following calculation is used:

$$\frac{\text{Total Revenue} + \text{Additional Debt Service Coverage} - \text{O\&M Expense}}{\text{Debt Service}} = 1.25$$

Or

$$\text{Additional Debt Service Coverage} = 1.25 (\text{Debt Service}) - \text{Total Revenue} + \text{O\&M Expense}$$

The E.D. did not calculate the additional amount for debt service coverage properly as did the Districts. For example, for the WTC Water system, additional debt service coverage is properly

⁵¹ Districts Exceptions at 15-16; Districts Exhibit 50 at 34.

⁵² *Id.* “Coverage requirements are a test of the adequacy of utility revenues and do not represent a specific cash requirement or funding obligation. The coverage requirements are intended to provide a measure of security for bondholders, and must be considered in determining the total annual revenue needed.”

⁵³ LCRA Exhibit JT-7.

⁵⁴ PFD at 50.

calculated as follows.

$$\text{Additional Debt Service Coverage} = 1.25(\$4,549,074) - \$8,414,847 + \$3,229,400^{55}$$

$$\text{Additional Debt Service Coverage} = \$500,896$$

To ensure that the debt service coverage meets the 1.25 ratio, the FY 2007 revenue requirement for WTC Water must include an additional \$500,896 in revenue. As LCRA already included additional revenue for Community Service, that Community Service amount must be deducted from the total additional amount of revenue necessary to meet the 1.25 debt service coverage. For example, if Community Service for the WTC Water system requires an additional \$298,333 in revenue, then the amount of additional revenue necessary to ensure a 1.25 ratio of debt service coverage is \$202,563 (*i.e.*, \$500,896-\$298,333), not the \$1,137,269 that the E.D. assumed. For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

6. Errors in Calculating Community Development Charges

The E.D. did not properly calculate the amount for Community Development either. According to LCRA, Community Development is 3% of the gross revenues.⁵⁶ For FY 2007, the gross revenue was \$8,414,847, so the total Community Development charge for WTC Water could not be more than \$252,445 (*i.e.*, Total Revenue of \$8,414,847 * 0.03). Yet for some reason, the E.D. included \$263,515 in his calculations for WTC Water. The E.D. made a similar error in his calculation for the Community Development charge for WTC Wastewater. For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

⁵⁵ Districts Exceptions at 34.

⁵⁶ LCRA Exhibit JT-7.

7. Errors in Calculating Non-Rate Revenues

Instead of using actual non-rate revenues from the administrative record, the E.D. used LCRA projections of non-rate revenues and then made more adjustments based on his assumptions. The E.D. said he calculated net, non-rate revenue for WTC Water of \$895,645 (*i.e.*, \$1,658,645 Total Non-Rate Revenue Less Excess Capacity Contribution). However, the actual non-rate revenue, as shown in the administrative record, excluding any excess capacity contribution, in FY 2007 for WTC Water was \$1,226,000.⁵⁷ For wastewater, the actual non-rate revenue in FY 2007, as shown in the administrative record, was \$872,000,⁵⁸ not the E.D.'s \$418,000. The impact of these errors is significant because the E.D. failed to include over \$800,000 in additional non-rate revenue in his calculation for the WTC Water system and he made a similar error in his calculation of non-rate revenue for the WTC Wastewater system. For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

8. Errors in Representing Customer Classes

For the first time in this long four (4) year process, the E.D. now claims that the Appellants protested the residential rates only.⁵⁹ He is mistaken as to the breadth of this rate appeal. In pleading after pleading, the Districts have made clear that their appeal applied to the LCRA rates charged to **all** customers:

⁵⁷ Districts Exhibit 46.

⁵⁸ Districts Exhibit 48.

⁵⁹ E.D. Exceptions at 7.

Nothing in the Districts' appeal raises any issue regarding any customer class issues, any disputes between customer classes, any customer class designations by the LCRA, or the different rates that the LCRA established between different customer classes. The Districts do not compare their retail water and wastewater rates to the rates of LCRA other customer classes, such as commercial or industrial customers. Instead, the Districts appealed the LCRA retail rates under Subchapter F of the Texas Water Code due to the unjust and unreasonable charges included in the LCRA retail ratemaking **for all customers**, which are the provisions established by the Texas Legislature for an appeal of retail water and wastewater rates established by a river authority.⁶⁰

The Districts represent customers from nearly every customer class, including commercial, construction, and residential. For the E.D. to now limit the discussion to residential customers only would be a violation of Section 49.2122 of the Texas Water Code, which the Commission already rejected in its Answer to the Certified Questions in the case.

Instead of looking at the total revenue, which is known for FY 2007, the E.D. goes through a tortured process to try to determine the revenue requirement for retail, residential customers only. By doing so, the E.D. places the entirety of any necessary increase to meet any revenue shortfall squarely on the backs of residential customers, ignoring any necessary increase for any other rate class. Most important, by focusing on residential customers only, the E.D. proposes setting rates in a blatantly prejudicial manner, which is a clear violation of Section 13.043 of the Texas Water Code.

The E.D. failed to perform any analysis of the LCRA allocations to any other customer class, and he did not compute rates for each customer class with the revenue requirement for each class. The E.D. failed to show any analysis justifying the rates charged to any other customer class. More important, the administrative record lacks any evidence regarding the

⁶⁰ WEST TRAVIS COUNTY MUD NOS. 3 AND 5'S BRIEF REGARDING THE INAPPLICABILITY OF SECTION 49.2122 OF THE TEXAS WATER CODE, March 6, 2009, at 3 (emphasis added).

adequacy of the other customer class rates to meet those other customer class revenue requirements. As LCRA failed to introduce any evidence into the record regarding any analysis that the rates charged to the other customer classes were just and reasonable, LCRA also failed in meeting its burden of proof in justifying the rates charged to all WTC Water and Wastewater customers. At a minimum, all rates should be rolled back to the rates that were in effect prior to August 22, 2007.

As shown above, the E.D.'s calculations for revenue requirements include error upon error. For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

B. Errors in E.D. Revenue Calculations and Rates

The E.D. attempted to calculate the revenue that would have been generated from retail, residential customers only from the third phase of the LCRA rate increase, applying the rates to a number of customers assumed to be served in FY 2007. As indicated above, the E.D. did not perform any analysis of the revenues that would have been recovered from other customer classes.

1. E.D. Used Erroneous Customer Data to Calculate Revenue Generated

In performing his analysis, the E.D. used a count of existing customers from the middle of FY 2006, 3,244, to calculate revenue generated, not the actual FY 2007 customer count.⁶¹ The E.D.'s calculation of revenue relied upon a customer count nearly a year and a half old and failed to factor in the growth of the system over that period, which LCRA witness, Mr. Stephen Kellicker, testified typically grew by 30% per year.⁶² By using 16-month old data from mid FY 2006 to calculate revenue generated, the E.D. underestimates revenue by more than 30% for FY 2007.

Unfortunately, LCRA offered only an estimate of connections for FY 2007 or 3,900 customers into the administrative record.⁶³ Still, LCRA customer count estimate is at least 20% greater than the E.D. used to calculate revenue.

While the E.D. used 16-month old customer count data to calculate revenue from base rate, he used a different set of data, projected consumption data, to calculate revenue from annual water usage.⁶⁴ Yet, again, water usage, wastewater billed, or any other rate determinants for FY 2007 are not in the administrative record -- another failure of LCRA to meet its burden of proof. But it also shows that the E.D. used apples and oranges to calculate rates because he used projected, not actual water usage data for FY 2007. For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

⁶¹ E.D. Exceptions, Attachment E.

⁶² LCRA Exceptions at 7.

⁶³ LCRA Exhibit SZ-7, Table 2w.

⁶⁴ E.D. Exceptions, Attachment E.

2. E.D. Used Erroneous Base Rates to Calculate Revenue

The ED also ignored the higher base rate that LCRA charges customers in the 290/HPR/Homestead rate districts. As shown below, the LCRA charges customers of the 290/HPR/Homestead rate district a higher base rate than what LCRA charges the customers in the Bee Cave/Bee Cave South rate district.⁶⁵

FY 2009	Bee Cave and Bee Cave South	290/HPR/Homestead
Minimum Bill		
5/8" Meter	\$ 31.65	\$ 57.50
3/4" Meter	\$ 47.50	\$ 57.50
1" Meter	\$ 79.15	\$ 86.25
1 1/2" Meter	\$ 158.25	\$ 143.75
2" Meter	\$ 253.20	\$ 287.50

However, the E.D. computed revenue recovered from the minimum bill on the lowest base rate only.⁶⁶ By using the wrong base rate, the E.D. underestimated revenue from the customers in the 290/HPR/Homestead rate district, which led, in turn, to his underestimate of total revenue from the WTC Water and Wastewater systems. For these reasons, the Commission should dismiss the E.D.'s calculations and his conclusions in their entirety and reinstate the previous rates.

3. Errors in Calculating Non-Rate Revenue

As stated above, the E.D. attempted to calculate non-rate revenue for both the WTC Water and Wastewater systems, but he used the wrong values for each system. Instead of using the actual non-rate revenue for FY 2007 in the administrative record, the E.D. used a projection of non-rate revenue from LCRA Exhibit SZ-13, and he then adjusted the number downward on

⁶⁵ LCRA Exhibit SZ-9.

⁶⁶ E.D. Exceptions, Attachment E.

an assumption that the projected non-rate revenue included the excess-capacity funding shown in LCRA Exhibit SZ-7.⁶⁷ Through his process, the E.D. calculated net, non-rate revenue of \$895,645.

A least two different values for actual FY 2007 non-rate revenue exist in the administrative record. The Districts' Exhibit WTC-46, which LCRA relied upon in its exceptions, reports actual non-rate revenue equaled \$1,226,000 for FY 2007. Bee Cave's Exhibit BC-67 Revised shows actual non-rate revenue equaled \$1,989,000 for FY 2007. Meanwhile, the E.D.'s estimated non-rate revenue was 27% lower than the actual number shown in Exhibit WTC-46 and 55% lower than the actual number in Exhibit BC-67 Revised.

FY 2007 Non-Rate Revenue	Source Document
\$ 1,226,000	Exhibit WTC-46.
\$ 1,989,264	Exhibit BC-67 R
\$ 895,645	E.D.'s Estimation

Clearly, the E.D.'s statement that actual data would not "have a material effect on rates" is false. The actual non-rate revenue is anywhere from \$330,355 to \$1,093,619 more than what the E.D. used in his calculation of the rate revenue requirement.

The cumulative effect of the E.D.'s many flaws show that neither the E.D.'s newly calculated revenue requirement nor rates are reliable, his analysis should be given no weight in this matter, and the Commission should reinstate the previous rates.

⁶⁷ E.D. Exceptions at 6-7.

III. REPLY TO EXCEPTIONS OF LCRA

A. Multi-Year Forecast is Unreliable

Contrary to the E.D.'s assertion that any 'ol methodology would produce just and reasonable rates, LCRA intentionally chose a method for calculating rates that was unproven and unreliable. The rates, the subject of this hearing, are hardly the result of the "long-established budget process"⁶⁸ that LCRA would like the Commission to believe it used. Rather, LCRA based these rates for the first time in LCRA history on an unproven method – forecasted expenditures five (5) years into the future.⁶⁹ LCRA own experts and internal rate analyst, Ms. Fishbeck, Mr. Stowe, and Ms. Flores, all admitted that they had never designed retail rates based upon a budget beyond the current fiscal year,⁷⁰ nor was Mr. Stowe, a 25-year veteran in rate design, aware of even one instance in which the Commission has recognized the use of a forecast five (5) years into the future to set a rate.⁷¹ As the ALJ found in his PFD⁷² and as the Districts presented in their Closing Arguments, Reply to Closing Arguments, and Exceptions to the PFD,⁷³ this approach rendered anything but just and reasonable rates.

The ALJ's statement that "rates must reflect costs"⁷⁴ comports with the analysis by the Texas Supreme Court in *PUC v. Houston Lighting & Power Company, et al.*, that, "[t]o ensure

⁶⁸ LCRA Exceptions at 8.

⁶⁹ Tr. at 882:19-21; Tr. at 1663:21-25.

⁷⁰ Tr. at 1334:7-9; Tr. at 1440:22-1441:4.

⁷¹ Tr. at 1531:15-19.

⁷² PFD at 1, 19.

⁷³ The Districts incorporate their Closing Arguments, Reply to Closing Arguments and Exceptions to the PFD herein, as if set out in full.

⁷⁴ PFD at 19.

that its rate is just and reasonable, a utility must prove that all operating expenses *have been actually incurred*.⁷⁵ That is to say, LCRA must show from historical records that its actual operating expenses are reasonable and necessary expenses for the utility service provided. It is uncontroverted, however, that the LCRA revenue requirement included costs for expenses not yet incurred, like debt service on water and wastewater infrastructure not yet constructed, and reservation fees for raw water reserved for future, non-existent customers.

Astonishingly, LCRA argues that there is no evidence in the record to support the ALJ's findings that FY 2008 or FY 2010 budget data were unreliable.⁷⁶ The record is replete with examples of the data's unreliability starting with Mr. Kellicker's own bold statement -- that the forecast or estimate need not be accurate or reliable but could be as much as 50% unreliable and still be "absolutely" reasonable.⁷⁷ Indeed, the evidence in the record shows that not only has the LCRA budgeting process been drastically unreliable in the past (the LCRA FY 2006 budget was off by 207% for water and 53% for wastewater),⁷⁸ but this same pattern of flawed budgeting is at play now. For example, the actual amount of net corporate residual costs allocated to the WTC Water system in FY 2007 missed the budgeted amount by over 100% (the actual amount allocated to the WTC Water system was \$508,000, when LCRA budgeted only \$253,000).⁷⁹ The FY 2007 budget for WTC Water missed the raw water reservation fee by 74%, materials and supplies by 160%, transportation by 282%, rentals by 1277%, and labor for professionals by

⁷⁵ *PUC v. Houston Lighting & Power Company, et.al.*, 748 S.W.2d 439, 441 (Tex. 1987) (emphasis added).

⁷⁶ LCRA Exceptions at 11.

⁷⁷ Tr. at 974:8-13.

⁷⁸ Tr. at 275:12-276-3; Tr. at 283:4-13.

⁷⁹ LCRA Exhibit SK-4; Tr. at 746:1-6.

838%.⁸⁰ Similarly, the WTC Wastewater budget in FY 2007 missed for various categories by as much as 417%.⁸¹

As to LCRA claim of reliability, Ms. Fishbeck neither audited LCRA data nor reviewed the LCRA revenue requirement to determine whether the amounts were valid.⁸² Significantly, Ms. Fishbeck made no effort to determine whether the costs were actually incurred in providing water or wastewater service to the WTC systems – the standard applied by the Supreme Court.⁸³ Not only was Ms. Fishbeck unaware of what LCRA adopted as its revenue requirement,⁸⁴ the LCRA internal rate analyst, Ms. Flores, testified that she did not review the revenue requirement to determine whether the costs included were reasonable or necessary.⁸⁵ More troubling, Ms. Flores was unaware of how her staff had projected out the budgeted revenue requirement data for FY 2006.⁸⁶ Finally, there was no evidence in the administrative record that the PUC finds multi-year forecasting a reasonable means to establish rates as the LCRA asserts.⁸⁷ On the contrary, there is no evidence to suggest the PUC has departed from its longstanding ratemaking standard that rates must have an historical basis (and actual operating expenses must be reasonable and

⁸⁰ LCRA Exhibit SK-4.

⁸¹ *Id.*

⁸² Tr. at 1368:17-22; Tr. at 1370:13-16.

⁸³ Tr. at 1369:1-4.

⁸⁴ Tr. at 1348:12-14.

⁸⁵ Tr. at 1630:18-21; Tr. at 1431:12-19; Tr. at 1505:3-5. Mr. Stowe also did not check the accuracy of the data used to develop the WTC revenue requirement.

⁸⁶ Tr. at 1612:2-17.

⁸⁷ LCRA Exceptions at 3, without citation to the administrative record.

necessary expenses for the utility service).⁸⁸ Certainly, no LCRA witness could vouch for the accuracy or reliability of the forecasted data, which was not based on historical data.

LCRA glosses over the fact that rates should be designed using expenses actually incurred. Instead, LCRA argues that use of its FY 2010 budget was reasonable because certain elements were “thoroughly and comprehensively determined.”⁸⁹ However, to calculate its FY 2010 budget, LCRA simply increased allocated expenses by three percent per year to account for anticipated inflation.⁹⁰ However, LCRA expert witness Jack Stowe testified that inflation was **not** an appropriate adjustment to calculate future revenue requirements.⁹¹ An assumed inflation rate is not a substitute for data from an historic test year adjusted for known and measurable changes. The ALJ agreed, noting that using the inflated data was not just or reasonable and resulted in FY 2010 budget data that was an unreliable forecast of anticipated expenses for setting rates in 2007.⁹²

B. Volume Allocation Methodology is Unreasonable

LCRA states the record has a significant amount of credible evidence demonstrating that volume is an appropriate cost driver.⁹³ Even a surface look at the evidence in the record tells another story. Like the multi-year budget forecasting, LCRA invented a new allocation system to drive its overhead costs onto the systems’ biggest users – some \$2.2 million more to WTC

⁸⁸ Districts’ Closing Argument at 7-8; LCRA Exhibit JT-22 (SOAH Docket No. 473-04-1662; PUC Docket No. 28906).

⁸⁹ LCRA Exceptions at 6.

⁹⁰ PFD at 19.

⁹¹ Tr. at 1488:4-6.

⁹² PFD at 19.

⁹³ LCRA Exceptions at 4.

than before the Cost Allocation Methodology was implemented.⁹⁴ Not only was this preferential allocation system never reviewed and approved by the LCRA Board,⁹⁵ no investigation was conducted (as Mr. Stowe recommended)⁹⁶ to assess whether the new cost allocators for the WTC system were appropriate or appropriately assigned.⁹⁷ Ms. Fishbeck who had never allocated costs based upon volume⁹⁸ could offer no opinion on whether the costs represented a fair allocation of costs to the WTC systems.⁹⁹

Contrary to LCRA statement that credible evidence supporting volume allocation abounds, Mr. Stowe also testified that the allocation of shared and indirect costs was **not** appropriate at the corporate level.¹⁰⁰ Furthermore, he testified that he had never allocated shared and indirect costs for any retail public utility based upon volume as the allocator, as his experience was limited solely to a wholesale provider of raw water and his rate design was developed on a contractual agreement.¹⁰¹ LCRA attempts to downplay this distinction by saying Mr. Stowe was drawing “conceptual similarities” among several large regional systems – but the facts remain that no retail provider has allocated to the utility level based on volume as LCRA has in this case.¹⁰² Finally, LCRA mischaracterizes the Districts’ expert witness, Don

⁹⁴ Tr. at 179:18-180:3. Through volume allocation, LCRA assigned almost twice as much overhead costs (\$671,353) for “management” than what direct labor is actually incurred (\$382,059).

⁹⁵ Tr. at 171:12-15.

⁹⁶ Tr. at 1501:15-19.

⁹⁷ Tr. at 1501:20-22; 1504:18-21.

⁹⁸ Tr. at 1367:7-9.

⁹⁹ Tr. at 1369:13-16.

¹⁰⁰ Tr. at 1464:16-20.

¹⁰¹ Tr. at 1479:16-1480:17.

¹⁰² Tr. at 1814:24-1818:7.

Rauschuber, who testified repeatedly that the LCRA allocation of O&M costs by use of a volume driver to push costs to the system levels was not only high (and higher than anything he had seen in his 38-year career), but huge.¹⁰³ This could hardly be mistaken as an endorsement of the LCRA volume allocation method.

LCRA also downplays the testimony of its engineer, Mr. Payne, who testified that higher or lower volumes do **not** impact the use of, and implicitly the costs of, several cost categories that LCRA allocates to the WTC systems (*i.e.*, maintenance costs, telecommunications costs, SCADA system costs, costs for plant security, Board member expenses, technology services, or engineering services).¹⁰⁴ In its Exception, LCRA attempted to recast Mr. Payne's testimony that some costs would not vary according to volume, because as LCRA later argued (without citation to the record), the costs he discussed were somehow not included in a specific cost pool.¹⁰⁵ But this is a distinction without a difference – it is telling that Mr. Payne was the only LCRA witness with an understanding of how water and wastewater systems actually operate and their necessary associated costs. Mr. Payne clearly indicated that the LCRA allocated costs do not vary based on higher or lower volume, and the ALJ is correct in his finding.¹⁰⁶

LCRA advocated the novel use of a volume allocator at the expense of direct labor, which it now views as “imprecise,” “too narrow a statistic” and “does not include all of the labor

¹⁰³ Districts Exhibit 1 at 49; Tr. at 1955:20-1956:7.

¹⁰⁴ Tr. at 431:10-437:8.

¹⁰⁵ LCRA Exceptions at 15.

¹⁰⁶ PDF at 30; Tr. 432:22-23.

involved in operating and supporting the utility system,” but this statement is illogical.¹⁰⁷ LCRA specifically uses direct labor to allocate certain costs already, including its operating center costs.

As set forth in detail below, the Districts’ vehemently disagree with the LCRA statement that the use of actual FY 2007 data and direct labor allocation somehow yields higher rates. According to the Districts’ analysis and after revelation of numerous LCRA calculation errors, a significant reduction in rates is warranted. The ALJ was correct that LCRA should not receive its rate case expenses in this case. Any award of rate case expenses to LCRA would, in any event, constitute “double dipping,” since WTC customers already paid for a part of these costs through rates (as well as their own legal fees).¹⁰⁸ For the same reason, LCRA should pay the full cost of the transcript expenses – particularly since LCRA burdened the record with its novel forecasting and allocation schemes through nine (9) witnesses when far fewer would have been adequate. Finally, as shown in the Districts’ Exceptions and herein, when calculated correctly, the rates prior to August 22, 2007 are more than adequate to recover the revenue requirement for the WTC systems and no recovery of lost revenue is justified.

IV. ERRORS IN LCRA CALCULATIONS AND ATTACHMENTS

LCRA and the E.D. drew conclusions from their flawed analyses that the third phase of rates was just and reasonable, despite the many reductions that the ALJ found were justified. The most significant adjustment directed by the ALJ was to change the allocation of costs from volume to direct labor. The LCRA allocated costs comprise approximately 70% of the total O&M expense in FY 2007. Originally, LCRA allocated these overhead costs to the WTC Water

¹⁰⁷ LCRA Exceptions at 20.

¹⁰⁸ PFD at 66.

and Wastewater systems largely on a volume allocation factor of approximately 60%. The ALJ required reallocation of those specific costs of service items and cost pools on the basis direct labor instead of the prior volume allocation basis. The direct labor allocation factor was approximately 20% of the LCRA WWUS cost pools. Both the E.D. and LCRA claimed that despite these downward adjustments, the third phase of the rate increase was justified. This absolutely defies logic, as adjusting **downward** over 70% of total O&M costs from an allocation basis of 60% to 20% results in a significant reduction of costs; yet, the E.D. and LCRA conclude that the third tier rates were still reasonable. This simply cannot be correct, as explained herein.

As described earlier with respect to the E.D. and set out below regarding LCRA, both parties relied upon an approach to developing and evaluating the LCRA rates that was flawed, and both made significant errors throughout their analyses that have a material impact on the final rates and revenues collected through those rates. For these reasons, the Commission should dismiss the LCRA's calculations and conclusions in their entirety and reinstate the previous rates.

A. LCRA Failed to Apply the ALJ's Adjustments in Calculating Revenue Requirements

1. WTC Water Errors

a. Errors in Determining Gross Cost Center Amounts

Like the E.D., LCRA attempted to "gross up" the shared/indirect cost pool numbers, shown in LCRA Exhibit SK-4 to estimate the total amount for each cost pool instead of using the actual numbers contained in the FY 2007 Water General Ledger. LCRA "grossed up" the costs shown on that exhibit based upon an assumption that the volume based allocations represent

56.6% of the gross cost-pool amount.¹⁰⁹ Additionally, LCRA used an assumption from the FY 2007 business plan for gross cost pool allocations, not the actual cost pool data from FY 2007, which is in the record as BC Exhibit Nos. 53 through 59. For the same reasons as shown for the E.D., LCRA did not need to calculate the cost pool totals, as the data is already in the record. The LCRA use of budgeted allocation factors to determine gross cost-center costs was not just unnecessary, but also inaccurate, because the actual FY 2007 cost pool data is in the administrative record. There is no need for the parties to guess at the value of each LCRA cost pool to be allocated.

Also, like the E.D., LCRA failed to properly account for the corporate residual costs and the corresponding credit. As discussed above, the cost and the credit are separate and distinct data entries, and are calculated using different allocation factors. Thus, treating corporate residual as a net number with a single allocation materially and severely overcharges the WTC Water system customers. Properly calculated, corporate residual goes from a charge of \$508,065 to a credit of \$901,519, which is a reduction in the WTC Water revenue requirement of \$1,409,584. The LCRA should have adjusted the costs, which were previously allocated on volume, by allocating on direct labor as directed by the ALJ. However, no change should be made to the credit amount, as it was not allocated on volume. The Districts properly calculated both the cost and the credit, as shown in Table Two of the Districts' Exceptions. For these reasons, the Commission should dismiss the LCRA's calculations and conclusions in their entirety and reinstate the previous rates.

¹⁰⁹ LCRA Exceptions at 33, Table 3 (LCRA obtained the 56.6% number from BC Exhibit No. 77).

b. Errors in Applying Revised Cost Allocations

LCRA presented allocated costs on 3 different tables (*i.e.*, Table Nos. 6, 7, and 8) in its Exceptions. However, careful examination of these tables reveals that the allocated costs and the direct costs as reported in these tables are inconsistent, as shown below:

i. Table 6 Errors

In this table, LCRA attempts to re-calculate the LCRA overhead cost pools allocated to WTC Water from the original LCRA allocation based on volume to direct labor. However, LCRA made significant errors in the calculations presented on Table 6. First, LCRA used a “gross-up” approach instead of using actual FY 2007 General Ledger values for the various cost pools, as required by the ALJ. Second, LCRA did not downwardly adjust the cost pools as required in Finding of Fact No. 91 resulting in \$1,840,014 in overhead costs improperly ascribed to the WTC Water, as shown on LCRA Table 6. The correct number that should be shown on Table 6 is \$807,001, as calculated and shown in the Districts’ Exceptions on Table Nos. One and Two.

In an attempt to justify its flawed calculations, LCRA stated, “. . . the exclusion of these costs and the re-allocation back to WTC water does not result in a decrease in allocation to WTC Water, but rather a minor increase to WTC Water.”¹¹⁰ This statement is incorrect for several reasons:

- LCRA stated that the basis for the ALJ’s recommendation for excluding the cost of service items shown in Finding of Fact No. 91 and others appears to be a misunderstanding of Mr. Stowe’s testimony. Simply stated - misunderstanding or not,

¹¹⁰ LCRA Exceptions at 36.

the ALJ found that LCRA did not meet its burden of proving that the cost of service items listed in Finding of Fact No. 91 and elsewhere are just and reasonable. The ALJ undertook the proper action by excluding these costs from LCRA FY 2007 cost of service. LCRA erred in not excluding the ALJ's recommended cost of service items from its analysis in determining the FY 2007 revenue requirement;

– LCRA attempted to justify not including the ALJ's exclusions by presenting a flawed and misleading analysis shown in LCRA Attachment "1" to its Exceptions. In Attachment "1", LCRA presented two almost identical calculation registers. The first register (*i.e.*, upper most register) calculated Shared/Indirect Cost Pool allocations corrected for direct labor. This first register results in a LCRA claimed Cost Pool Allocation to WTC Water of \$1,840,015 (*i.e.*, the number erroneously reported on LCRA Table 6, 7 and 8). The second register results in a LCRA calculated Cost Pool Allocation to WTC Water - **after** LCRA allegedly applied the ALJ's reductions of \$1,842,811 – but in a higher amount than the amount LCRA showed **before** application of the ALJ's reductions. This conclusion is ludicrous and incorrect, because LCRA used a "sleight of hand" card trick in the second register shown in its Attachment "1". In this second register, LCRA deducted the ALJ's reductions, as generally determined by Bee Cave expert Ms. Heddin, from the Cost Pool, but then turned around and added the adjusted exclusions back into its calculation to derive a Cost Pool allocation greater than without the exclusions. Essentially, LCRA removed the exclusions from the gross cost pools as required by the ALJ but then added them back into the revenue requirement. The flaw of this approach should have been apparent to LCRA when it arrived at an amount allocated

to WTC Water, after exclusions, which was greater than the amount it determined to be allocated before exclusions.

For these reasons, the Commission should dismiss the LCRA's calculations and conclusions in their entirety and reinstate the previous rates.

ii. Table 7 Errors

In this table, LCRA calculated a WTC Water revenue requirement of \$10,465,672, under the table heading titled, "Expenses Based on PFD," which is inaccurate for the following reasons:

- LCRA used a "Direct O&M" cost of \$1,935,893 reported directly from LCRA Exhibit SK-4. However, the correct FY 2007 Direct O&M cost is \$1,954,429 as per the FY 2007 Water General Ledger;
- LCRA did not adjust the Direct O&M cost to include the ALJ's reductions. As calculated from the Districts' Exceptions, Table One, the correct Direct O&M cost for FY 2007 is \$1,897,307¹¹¹ (*i.e.*, FY 2007 accurate Direct O&M Cost of \$1,954,429 less the ALJ's reductions to direct costs of \$57,122);
- LCRA included the erroneous allocated cost of \$1,840,014 from Table 6 instead of the correct amount of \$807,001, as discussed above;
- LCRA did not recalculate the "Community Development" cost for FY 2007, based on applying the ALJ's correct downward adjustments described above. The correct FY 2007 Community Development cost is \$233,254 (*see* Districts' Exceptions, Table One);

¹¹¹ Calculated from Districts' Exceptions, Table Nos. One and Two.

- LCRA incorrectly included an “Operating Reserve Cost” of \$179,997, which should be \$0 as required by the ALJ’s reductions; and,
- LCRA incorrectly included a “Debt Service Coverage” (a.k.a. Time Coverage) of \$1,137,269, instead of the amount of \$202,563, as correctly calculated in the Districts’ Exceptions.

Given the correct adjustments, the LCRA Table 7 “Expenses Based on PFD” should be as follows:

Expense Category	Amount Based on PFD
Direct O&M	\$ 1,897,307
Allocated Costs	\$ 807,001
Debt Service	\$ 4,549,074
Debt Service Coverage	\$ 202,563
Community Development	\$ 233,354
Operating Reserves	\$ 0
Raw Water	\$ 525,092
Total	\$ 8,214,391

Therefore, LCRA failed to include an adjusted revenue requirement as directed by the ALJ. When properly adjusted, the FY 2007 WTC Water revenue requirement is clearly less than the actual WTC Water revenue in FY 2007. For these reasons, the Commission should dismiss the LCRA’s calculations and conclusions in their entirety and reinstate the previous rates.

iii. Table 8 Errors

The purpose of LCRA Table 8 was to calculate the annual revenue requirement for FY 2007. LCRA included the same erroneous numbers in Table 8 as presented in LCRA Table Nos. 6 and 7 and ended up with the same result, \$10,465,672, despite the fact that Table 8 included **different** allocated costs. Again, this is another LCRA calculation error. As discussed above, the correct total for LCRA FY 2007 Water expense is \$8,214,391, not \$10,465,672.

Deducting LCRA reported non-rate revenue of \$1,226,000, as shown on its Table 8, from the actual FY 2007 Water revenue of \$8,414,391 should result in a remaining revenue requirement of \$7,188,391, not the \$9,239,672 shown on LCRA Table 8. However, the use of a water non-rate revenue requirement of \$1,226,000 was also flawed and incorrect. LCRA relied upon Exhibit WTC-46 as the source of non-rate revenues for the purposes of the determination of its purported revenue requirements. However, BC Exhibit No. 67 shows that the actual FY 2007 WTC Water non-rate revenue was \$1,989,000, which is uncontested in the record. Using the actual FY 2007 non-rate revenue of \$1,989,000 results in a corrected Table 8 Revenue Requirement of \$ 6,225,391, calculated as follows:

Expense Category	Amount Based on PFD
Direct O&M	\$ 1,897,307
Allocated Costs	\$ 807,001
Debt Service	\$ 4,549,074
Debt Service Coverage	\$ 202,563
Community Development	\$ 233,354
Operating Reserves	\$ 0
Raw Water	\$ 525,092
Total Revenue Requirement	\$ 8,214,391
Less Non-Rate Revenue	(\$ 1,989,000)
REVENUE REQUIREMENT FROM RATES	<u>\$ 6,225,391</u>

Clearly, the calculated rate revenue requirement for the WTC Water system in FY 2007 of \$6,225,391 is lower than the actual rate revenue of \$6,772,000.¹¹² For these reasons, the Commission should dismiss the LCRA's calculations and conclusions in their entirety and reinstate the previous rates because LCRA does not need a water rate increase – **the actual rate revenue exceeded the revenue requirement by more than \$500,000 in FY 2007.**

¹¹² Districts Exhibit 46 (Rate Revenue if FY 2007 = \$5,187,000 (Retail) + \$1,585,000 (Wholesale)).

2. WTC Wastewater Errors

LCRA presents its WTC Wastewater revenue requirements in Table Nos. 9 through 13 of its Exceptions. Examination of these tables and supporting written text reveals that LCRA used the same flawed approach and methodology to derive its recommended FY 2007 WTC Wastewater revenue requirement as it did to finesse its recommended FY 2007 WTC Water revenue requirement. Consequently, LCRA made the same errors and reached the same invalid conclusions for both utilities. With specific reference to the FY 2007 WTC Wastewater revenue requirement, LCRA made the following errors in its calculations:

- For calculating allocated costs, LCRA used the “gross up” method instead of employing actual costs presented in the FY 2007 WTC Wastewater general ledger;
- LCRA did not reduce the FY 2007 allocated costs in accordance with the ALJ’s adjustments listed in Finding of Fact No. 91;
- LCRA did not properly allocate costs from the cost pools to the WTC Wastewater system based on a direct labor allocator as directed by the ALJ;
- LCRA did not reduce certain direct O&M expenses as directed by the ALJ;
- LCRA did not recalculate the community development in accordance with the aforementioned adjustments; and,
- LCRA included an operating reserve expense, which was specifically excluded by the ALJ.

As shown in Table 13 of the LCRA Exceptions, LCRA projected a FY 2007 WTC Wastewater revenue requirement of \$3,637,639, which incorporated the errors described above. Adjusted in

accordance with the ALJ's directive, the Districts' Exceptions included the correct FY 2007 WTC Wastewater revenue requirement of \$3,007,618,¹¹³ a difference of \$630,021.

Furthermore, subtracting the actual FY 2007 wastewater sales revenue reported in the Districts' Exhibit 48 of \$2,208,000 from the correct revenue requirement results in a deficit of \$804,618, which is a revenue shortfall of only 36.4%. In other words, all wastewater revenue streams, including rates charged all customers, should be raised approximately 36.4% from the pre-2007 rates. As shown in Table Four of the Districts' Exceptions, the interim rates for wastewater meet the ALJ's adjusted revenue requirement.

Therefore, LCRA does not need the third phase wastewater rates it requested, because third phase wastewater rates would result in a revenue windfall for LCRA and would be punitive to WTC wastewater customers. However, because LCRA failed to offer usage and consumption data and such actual data does not exist in the record, the Commission should dismiss the LCRA's wastewater calculations and conclusions in their entirety and reinstate the previous rates.

B. Errors in LCRA Rate Design

LCRA utilized projected customer count data from Exhibit SZ-7, Table 2W as a base-line for determining water revenue to be recovered from the minimum bill. LCRA then distributed the assumed customer count between the meter sizes making the assumption that the distribution among meter sizes would be consistent with the FY 2006 actual customer count. Thus, LCRA based its analyses on projections of customer count made in the rate study applied to an assumption of meter size distribution. LCRA did not use actual FY 2007 data in the

¹¹³ Districts Exceptions, Table Nos. One and Two.

performance of this analysis notwithstanding the ALJ's clear directive to use actual FY 2007 data. Furthermore, as described earlier with respect to the E.D.'s customer count, the rate study assumed growth of 20% for FY 2007, which contradicts Mr. Kellicker's testimony that the system grew at a rate of 30% per year. Thus, LCRA analysis is under-stating customer count.

LCRA also utilized annual residential consumption of 640,349,918 gallons as the projected annual customer usage, instead of the actual FY 2007 water consumption for all customers. As previously described, the rate study projected 20% growth in the residential customer count, while the testimony of Mr. Kellicker stated that the system grew at a rate of 30% in FY 2007. As a result, LCRA analysis grossly understates consumption.

LCRA failed to calculate the revenue generated from consumption using its tiered rate structure. In its rate structure, LCRA charges customers more per gallon when monthly usage exceeds certain ranges.

LCRA Rate Tiers¹¹⁴

Monthly Usage, in Gallons	Pre-2007 Rates	FY 2007 Rates	FY 2008 Rates	FY 2009 Rates
0 – 1,000	\$0.00	\$3.30	\$3.80	\$5.10
1,001 – 10,000	\$2.80	\$3.30	\$3.80	\$5.10
10,001 - 20,000	\$3.50	\$4.10	\$5.00	\$6.30
20,001 – 25,000	\$3.50	\$4.60	\$6.00	\$8.60
25,001 – 50,000	\$5.75	\$6.70	\$8.10	\$10.30
Over 50,000	\$6.50	\$8.50	\$10.20	\$13.00

However, in calculating revenue from consumption, LCRA used an average monthly usage, calculated by simply dividing the annual consumption of 640 million gallons by the 3,900 connections by 12 months, which resulted in an average usage per connection of 13,683 gallons.

¹¹⁴ LCRA Exhibit SZ-9.

This estimate is an annualized average and is in no way representative of actual consumption¹¹⁵ in the warmer season when consumption is much higher than average. By using an average, instead of actual consumption, LCRA underestimated revenue generated by the higher tiers of the LCRA rates. Instead of using monthly consumption from all rate tiers, the LCRA approach assumed that all of the consumption throughout the year was billed within the first 2 rate tiers only. As a result of this error, LCRA has grossly understated the revenues recovered from all of the LCRA rates, including the Phase 3 rates. Since LCRA grossly underestimated revenue, its comparison of revenue to cost is inaccurate. Thus, LCRA lacks the ability to accurately compare actual revenue generated with actual costs for the WTC Water and Wastewater system, and neither the Commission nor the Board of Directors of LCRA had a way to determine whether a rate increase was even necessary. For these reasons, the Commission should dismiss the LCRA's calculations and conclusions in their entirety and reinstate the previous rates.

V. **CONCLUSION**

For the foregoing reasons, and those urged in their Closing Argument, Reply to Closing Arguments, and Exceptions to the PFD, the Districts request that the Commission overturn the water and wastewater rates adopted by the LCRA on August 22, 2007 on the basis of the administrative record currently in place and reinstate the rates as they existed prior to August 22, 2007. Alternatively, the Districts request that the Commission adjust the rates as shown in the Districts' Exceptions and this Reply and order a refund to the WTC ratepayers accordingly.

¹¹⁵ As stated previously, LCRA failed to offer any actual consumption data into the record.

Respectfully submitted,

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By: _____
Randall B. Wilburn

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CERTIFICATE OF SERVICE

This is to certify that the undersigned sent a true and correct copy of the foregoing Districts' Exceptions to the Proposal for Decision in accordance with the applicable agency rules, as noted below, on this 10th day of March 2011 to the following parties:

The Honorable Henry D. Card, Administrative Law Judge

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